

THE EFFECTIVENESS OF THE IMPLEMENTATION OF CIPAA 2012 IN  
ALLEVIATING THE PAYMENT ILLS OF MALAYSIA CONSTRUCTION  
INDUSTRY

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## **DEDICATION**

Specially dedicated

To Sally, my mum—thanks for having and sharing  
one of the largest hearts on the planet.

To Stewart, my dad—you are kind and talented. Thanks for guidance  
and showing the patience along the way.

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## **ABSTRACT**

Some expert has doubted the effectiveness of CIPAA 2012 in relieving the payment problems in the industry as most of the court decisions were held in favour of the non-paying party preceded by the escalation of adjudication generated litigation cases as well as the presence of inconsistencies of the court in interpreting the Act. Despite several approaches taken by AIAC to emphasize the effectiveness of CIPAA 2012 in resolving payment disputes, some industry players still doubted or unaware of the effectiveness of CIPAA 2012 to the entire industry. Hence, this research is conducted with the objective to determine the effectiveness of CIPAA 2012 in alleviating the payment problems in the construction industry. At its inception, the study will reveal the payment ills followed by the methods proposed to overcome payment ills before venturing into definition and characteristic of adjudication. Further, types of adjudication will be chew over preceded by advantages and disadvantages of CIPAA. Then, characteristic of CIPAA 2012 will be revealed following by the implication of CIPAA 2012 to the industry and at last the gist of the research which is the effectiveness of CIPAA 2012 discussed by a few experts will be disclosed. Research methodology used was the interviewees were required to construe the data portrayed by AIAC. The interview questions comprised of open and closed end questions focusing on the personal particular and questions related to the topic discussed and interviewees were encouraged to provide their opinions on the subject matter. Data collected will be analysed and elaborated by the author in detail. The findings clearly showed that CIPAA 2012 is effective in alleviating payment problems as it helps claimant to recover payment in a quicker manner and it also disclosed that CIPAA 2012 is going to provide regular and timely payment as it will slowly change the payment culture of the stakeholders.

## **ABSTRAK**

Sesetengah pakar telah meragui keberkesanan CIPAA 2012 dalam melegakan masalah pembayaran dalam industri kerana kebanyakan keputusan mahkamah dipertahankan memihak kepada parti yang tidak membayar dan kes litigasi terjana sebab adjudikasi telah meningkat serta ketidakkonsistenan mahkamah dalam menafsirkan Akta tersebut. Walaupun AIAC telah menekankan keberkesanan CIPAA 2012 beberapa kali dalam menyelesaikan pertikaian pembayaran, tetapi beberapa pemain industri masih meragui atau tidak menyedari keberkesanan CIPAA 2012 untuk keseluruhan industri. Oleh itu, kajian ini dijalankan dengan objektif untuk menentukan keberkesanan CIPAA 2012 dalam mengurangkan masalah pembayaran dalam Industri Pembinaan. Pada permulaannya, kajian ini akan mendedahkan masalah pembayaran. Berikutan dengan kaedah yang dicadangkan untuk mengatasi masalah pembayaran sebelum meneroka definisi dan ciri penghukuman. Selanjutnya, jenis adjudikasi akan dijelaskan. Kelebihan dan kelemahan CIPAA akan dibincangkan. Kemudian, ciri CIPAA 2012 akan diturunkan berikutan implikasi CIPAA 2012 kepada industri dan pada akhirnya inti penyelidikan yang merupakan keberkesanan CIPAA 2012 yang dibincangkan oleh beberapa pakar akan didedahkan. Metodologi penyelidikan yang digunakan adalah diwawancara yang diperlukan untuk mendefinisikan data yang digambarkan oleh AIAC. Soalan-soalan temuduga terdiri daripada soalan terbuka dan tertutup dan ia dibahagikan kepada Seksyen A dan B. Seksyen A adalah mengenai perkara peribadi dan Bahagian B terdiri daripada soalan yang berkaitan dengan topik yang dibincangkan. Para pakar yang diwawancara digalakkan untuk memberi pendapat mereka mengenai subjek perkara. Data yang dikumpul akan dianalisis dan diuraikan seterusnya. Penemuan jelas menunjukkan bahawa CIPAA 2012 berkesan dalam mengurangkan masalah pembayaran kerana ia membantu pihak menuntut untuk memulihkan pembayaran dengan lebih cepat dan ia juga mendedahkan bahawa CIPAA 2012 akan menyediakan pembayaran secara tetap dan tepat kerana pemain industri akan perlahan-lahan mengubah budaya pembayaran.

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## **LIST OF SYMBOLS / ABBREVIATIONS**

ADR	- Alternative dispute resolution
ANB	- Adjudicator Nominating Body
BCA	- Building and Construction Authority Singapore
CEDR	- Centre for effective dispute resolution
CIDB	- Construction Industry Development Board
CIPAA 2012	- Construction Industry Payment and Adjudication Act 2012
EPF	- Employee Provident Fund
GDP	- Gross Domestic Product
HGCRA 1996	- Housing Grants, Construction & Regeneration Act 1996
AIAC	- Asian International Arbitration Centre
MBAM	- Master Builders Association Malaysia
NSW	- New South Wales
RICS	- Royal Institution of Chartered Surveyors
RISM	- Royal Institution of Surveyors Malaysia
TCC	- Technology and Construction Court of Queens Bench Division of the High Court
TDR	- Traditional dispute resolution
UK	- United Kingdom
USA	- United States of America

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## **CHAPTER 1**

### **INTRODUCTION**

#### **1.1 Background of the study**

Construction industry plays a vital role in Malaysia's economy and it is considered as the key sector that contributes to the country's economy growth. According to the report portrayed by Ministry of Finance (2017), construction industry contributed approximately 4.6% of the GDP in Malaysia's economy in 2017 and it is expected to record a robust growth of 7.5% in 2018. At the same time, Foo (2017) asserted that the brick and mortar industry supports the growth of roughly 140 other downstream industries. Hence, it has an indirect multiplier effect on other segments of Malaysian economy (Lim, 2012). Another researcher, Oon (2003) concurred that the said industry was one of the anchors in Malaysia's economic progress so it can be used as a barometer to measure Malaysia's economic performance. Different people may have different outlook on a country's economic situation, but normally when a country's economy headed downwards, the government will boost up the economy of the country by allocating a substantial amount of fund for the development of the brick and mortar industry. In addition, many participants in the economy rely on construction industry as it provides accommodation, work opportunity and to further extent, acquiring properties as capital assets for income generation. In other words, construction industry basically creates wealth, enhances the quality of life and decreases unemployment rate.

In Malaysia, construction embraces a wide range of activities which stretch from easy private homes' renovation works to large mega construction projects. Each of this building activity is distinct and hence it will definitely create its individual unique type of criteria, needs and conditions. People from all walks of life comprising employer groups, contractors, suppliers, manufacturers and professionals contain their own requirement, which sometimes poses contradicting objectives (Supardi, Adnan & Mohammad, 2011). The dissimilarity and contrasting objectives of both developer and contractors are one of the reasons why construction industry is considered as a fertile source of disputes.

Under normal circumstances, the engineering and construction contracts vis-à-vis the contract entered into by the participants clearly stipulated that it is the contractor's responsibilities to carry out the works such as construction, material supply, installation and so forth. This is considered as the promise he made to the employer. On the other hand, the paymaster or the payer shall also keep his promise to pay the contractor on time when the work is delivered. In plain English, client's main role is to ensure that payment is made in a timely manner to the contractor based on the actual work done. If the client fails to keep his promise, then it is considered as a breach of contract (Robinson, Lavers and Heng, 1996).

The triumph of a construction project necessitates the timely flow of money from the proprietor to the contractor down to the subcontractors, sub-subcontractors, suppliers as well as the vendors (May & Siddiqi, 2006). Likewise, Chow (2005) said that when one keeps an eye on the relationships from upstream players to downstream players, it is apparent that all the participants in the brick and mortar industry depend for their livelihoods on the generated cash flow. Hence, payment is regarded as the life force of the construction industry. Unfortunately, Malaysia's construction industry is haunted by legacy issue namely, payment dilemmas. The payment issues in Malaysia's construction industry are caused by several factors such as project financing, inadequate contract terms, under-capitalized employer, payment default, inadequate dispute resolution procedures

and security of payment (Lim, 2007). Lim (2007) further emphasized that work carried out in construction industry was delivered in pyramidal manner, thus if the payment disputes appeared at the higher end of the hierarchy it will definitely initiate the cash flow problem down the chain. Strictly speaking, if client did not pay the employee or payments have been unduly delayed by the paymaster then the whole supply chain will collapse and it will eventually put the building consultants, contractors, subcontractors and suppliers out of business.

In order to overcome the aforementioned disputes, CIDB was being appointed to carry out research, consult and examine the payment ills involving the experiences and solutions of other jurisdictions which were haunted by similar dilemmas. After numerous consultation and feedback from industry practitioners, CIDB finally conceived a statutory solution by proposing the enactment of CIPAA 2012 in Malaysia. AIAC (2018) reported that the enactment of CIPAA 2012 is a vital breakthrough in order to transform the construction justice in Malaysia. Hopefully, to minimise the number of payment disputes cases and decrease the number of contractors undergoing insolvency in Malaysia's construction industry.

## **1.2 Problem Statement**

The payment quandaries that haunted Malaysia's construction industry since the olden times are actually inter-related. According to Naseem Ali (2006), one of the most common and persisting issues was payment defaults particularly delay and non-payment which is affecting the entire supply delivery chain. Hasmori, Ismail and Said (2012) further strengthened the notion by expounding that late and non-payment problems or rather contractors' payment woes involved many participants in the brick and mortar



industry, be it in government or private financed projects. Late and/or non-payment dilemmas were unquestionable, *inter alia*, that causes severe cash flow problems especially to contractors. Consequently, this would have a ‘chain reaction’ effect down the contractual payment flow. The significance of cash flow was also acknowledged by late Lord Denning in *Dawnays Ltd. v. FG Minter* [1971] 2 All ER 1389 who succinctly expressed cash flow as the “lifeblood of the enterprise”. Due to the ever-increasing numbers of payment quandaries, the number of contractors who went into bankruptcy increased drastically in the recent years.

Furthermore, Lim (2007) also stressed on the emergence of huge number of under-capitalized proprietors, who planned to commence constructions projects without having sufficient capital, as by-law did not oblige a project to be fully paid before construction begin. The factor pointed out earlier was concurred by Kho and Rahman (2010) who stated that scarcity of client’s capital to finance the project was one of the factors that give rise to the issues of poor cash flow in the supply chain. In that event, many contractors, sub-contractors, supplier and even consultants will open their arms to the risk of not getting paid.

Most if not all, the present construction contract contained no proper express clauses for a payment mechanism and this give rise to the problems of non-payment or late payment (Naseem Ali, 2006). This is further elucidated by Lim (2007) that current indenture is being too biased to the proprietor rather than the contractors. In plain English, it means most of the time the contractual negotiating power favours the proprietor instead of the contractors. This was exhibited in the case of *Kah Seng Construction Sdn Bhd v Selsin Development Sdn Bhd* [1996] MLJU 359, the court ruled that contractor has no autonomy right to stop work because of late and/ or non-payment. Withal, the situation deteriorates with the presence of ‘pay-when-paid’ and ‘pay-if-paid’ clauses in the construction contract and proprietor had also being safeguard financially through performance bond and retention sum. Refer to case of *Ryoden (M) Sdn Bhd v Syarikat*

*Pembinaan Yeoh Tiong Lay Sdn Bhd* [1992] 1 MLJ 33, the court held that it would be in contrast to encompass clause 27(a)(vii) of the main contract into the sub-contract with the express clause 11(b) of the sub-contract which oblige the main contractor to inform or pay the sub-contractor within 14 days upon receipt of payment certificate issued by the architect and there was no proof that architect had issued any certificate under clause 8(a) of the sub-contract. Besides the aforesaid case, the greatly debatable issue about the presence of conditional payment clauses in construction contract was also discussed in the case of *Dunlop & Ranken Ltd v Hendall Steel* (1957) 3 All ER 344. In this case, the court held that contractor only entitled to receive payment upon the issuance of certificate by the Architect, S.O or Contract Administrator. Lord Goddard CJ asserted that:

*“A Contractor who has spent on the materials and labour, wants money from time to time, and it is very clear that, until the Architect has issues a certificate, the Contractor has no right to receive any sum of money from his Proprietor until the Contractor can send or provide the building owner a certificate from the Architect, the Contractor cannot get anything.”*

Thence, due to the way that most of the construction contract drafted and the presence of contingent or conditional payment clause, it was evident that most of the construction contracts in Malaysia operate to the prejudice of the proprietor.

The payment problems raised actually resulted in cash flow being squeezed while slowing down the physical development of construction work. All of these dilemmas initiate the curiosity of the author to carry out a research to determine the effectiveness of the said Act in alleviating the payment ills after the Act has been started to be executed in Malaysian construction industry.

### **1.3 Previous Similar Studies**

In view of the intention to ascertain and analyse the effectiveness of implementation of statutory adjudication in a particular country, various studies were conducted by different international researchers or scholars to examine the implication before and after the adoption of statutory adjudication in their respective countries.

One of the previous studies carried out was pertaining to the enforcement of statutory adjudication from Singapore's perspectives which encompassed surveys done by Building and Construction Authority (BCA) in collecting feedback from contractors and developers. The result was Singapore adjudication regime has successfully achieved its' objectives to expedite payment, improves cash flow and profitability within construction industry as well as minimizing the use of litigation and arbitration proceeding to resolve construction payment disputes. Besides, the result shown in another research paper done by Teo (2008) regarding Singapore's adjudication also exhibited that 92% of the adjudication cases were determined in favour of the claimant, meaning that most of the claimant has successfully retrieved their money through Building and Construction Industry Security of Payment Act 2004, Singapore Act.

In addition, there was another similar research conducted by Che Munaaim et al (2012) to investigate the factors that cause delay and non-payment in the industry which aid the government and relevant practitioners to find out effective methods to sustain cash flow in Malaysian construction industry among the contractors or aggrieved unpaid claimants. The findings exhibited the importance of having proper management and documentation, communication and contract as well as culture and attitude in solving major concerns of delayed and non-payments such as paymaster's poor financial management, delay in issuance of certifications and local attitudes. All of these served as

a platform to reflect the payment scenarios in Malaysian construction industry prior to the presence of Construction Industry Payment Adjudication Act 2012 (CIPAA 2012).

The author also found out that there was a paper chew over the development of statutory adjudication, noting its origin from UK and comparing adjudication among a few jurisdictions namely Australia, New Zealand, Singapore, Hong Kong and South Africa (Dancaster, C., 2008). This paper described the impact of the procedures of different jurisdiction's dispute resolution processes by the portrayed of the statistics of case workload from the body that governed the particular adjudication act. The paper also displayed the statistics published by Technology and Construction Court (TCC) in England and Wales, there was a reduction on the number of construction disputes referred to litigation and arbitration after the advent of construction adjudication and also 80% of the claimant and respondent accepted the adjudicator's decision after the reference to adjudication.

A fieldwork regarding the impact of the Building and Construction Industry Security of Payment Act 1999 (NSW) ('the Act') towards New South Wales construction industry was also carried out by the respective local academicians namely, Uher, T.E. and Brand, M.C. (2008). In this fieldwork the scholars examine the impact of the Act on subcontractors, contractors and clients in New South Wales ('NSW'). Data for the findings displayed that the impact of the Act has been largely a positive one with subcontractors' being highly successful at adjudication from subcontractors' opinions. On the other hand, contractors have been exposed to 'ambush' claims by subcontractors, which is an unfavourable result of the strict time demands the Act places on the parties. Whilst there are no reliable proofs found to show the impact (if any) of the Act on client organizations. By and large, the scholars summarised that claimant who normally consists of contractors and sub-contractors have been extremely winning under the Adjudication Act in New South Wales, so it clearly shows how effective is the Act in alleviating the

payment ills down the supply delivery chain of their respective country.

A great deal of previous studies on payment ills in the construction industry and the effect of statutory adjudication towards the construction industry after its implementation has encouraged the author to carry out a study about the impact of CIPAA 2012 implementation on the construction industry in order to determine the effectiveness of CIPAA 2012 in alleviating the payment dilemmas in the brick and mortar industry.

#### **1.4 Research Questions**

In order to determine the effectiveness of CIPAA 2012 in alleviating the payment ills, it is fundamental for the author to ask the following questions:

1. Does the enforcement of CIPAA 2012 in the construction industry facilitates regular and timely payment?
2. Does the execution of CIPAA 2012 in the construction industry helps the claimants to recover their payment?
3. Does the execution of CIPAA 2012 considered a speedy dispute resolution that can help claimants to recover their payment in a faster pace?

## **1.5 Research Aim**

Recently, Construction Industry Payment and Adjudication Act 2012 (CIPAA 2012) is often being thrashed out as one of the remedies that allow unpaid contractors or aggrieved claimants to get paid for work delivered. Due to the fact that CIPAA 2012 is only started to be executed four years ago, there is lack of reliable evidences that can enlighten the contractors about the outcomes that they will face when CIPAA 2012 is initiated against clients or main contractors. Hence, the research aims to assess the effectiveness of the implementation of CIPAA 2012 to cash flow problem in the Malaysian Construction Industry.

## **1.6 Research Objectives**

The objective of this research is as follow:

1. To determine the effectiveness of CIPAA 2012 in alleviating payment problems in the construction industry.

## **1.7 Research Hypothesis**

Cash flow will improve tremendously in the industry's supply chain with the implementation of CIPAA 2012.

## **1.8 Research Methodology**

The author will use mixed-mode of research method i.e. primary and secondary data in this dissertation. Data analysis from the report published by Asian International Arbitration Centre (AIAC) is used as secondary source of data collection. Whilst for primary data collection, the author will conduct semi-structured interviews with small numbers of respondent in order to obtain their perspectives regarding the effectiveness of CIPAA 2012 in alleviating payment problems.

The statistics which will be adopted by the author in this dissertation encompass the data which show the frequency of decided adjudication being referred to High Court or Arbitration, frequency of decision by adjudicator held in favour of the claimant, whether the disputants satisfied with the outcome of the decided adjudication process, whether the disputing parties chose for CIPAA adjudication over other alternative dispute resolution (ADR) procedures due to summary nature and cost effectiveness, whether the disputants would referred the decided adjudications to arbitration and court and whether the respondent would make full payment on the time frame set after the decided adjudication has been served on the respondent etc so as to gauge the effectiveness of the application of CIPAA 2012 in the construction industry in terms of whether or not it will helps to reduce payment ills.

Ultimately, all the primary and secondary data collected will be analysed and displayed in Chapter 4. The findings generated will be based on the data collected. In short, the stages to conduct this dissertation are shown in Figure 1.1.



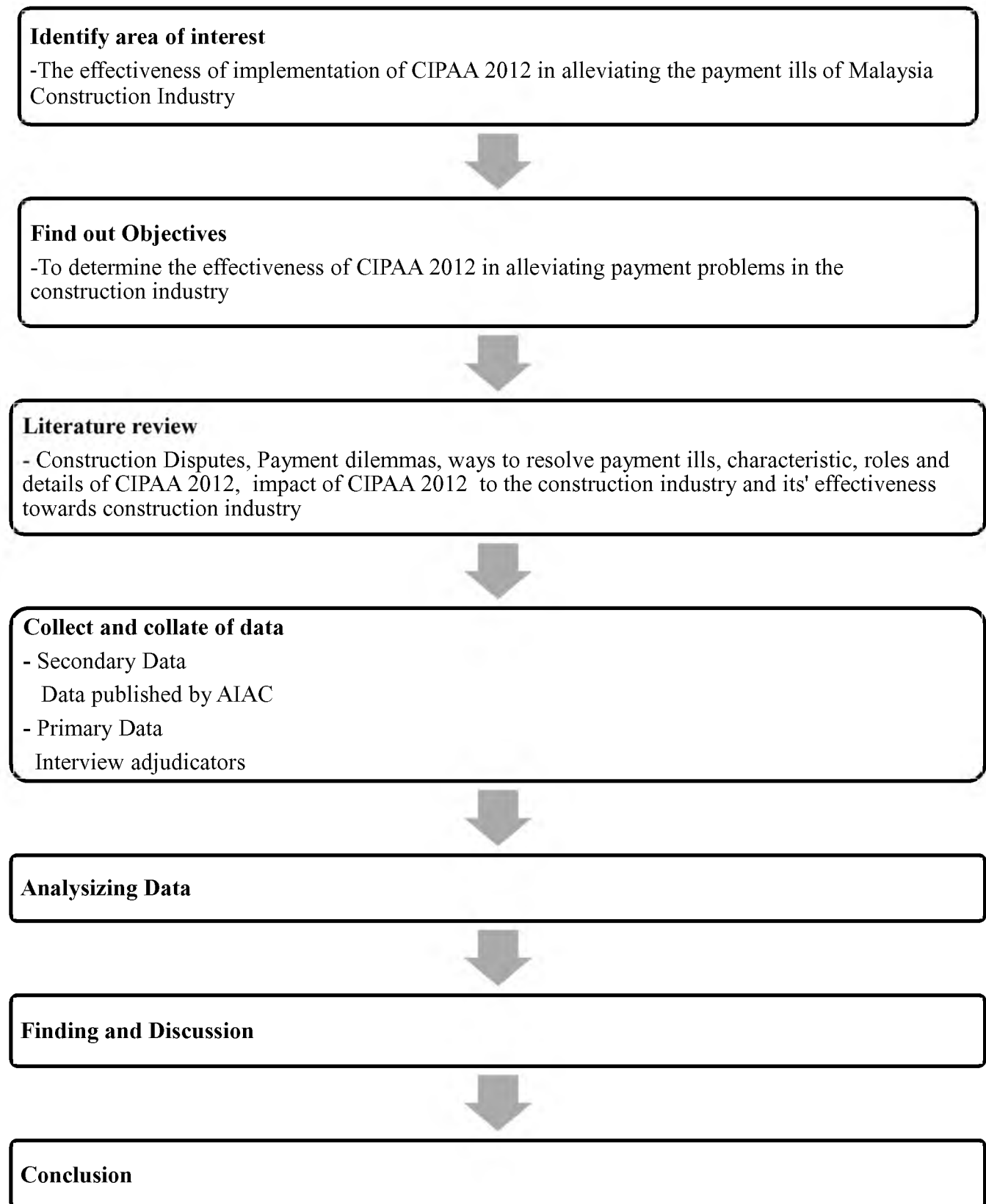


Figure 1.1: Flow chart of the Research Work

## **1.9 Research Design**

This dissertation is categorised into 5 major chapters. Chapter 1 encompasses the introduction of the research which describes the ills in construction industry, problem statements, previous similar studies, aim, objectives, hypothesis, research questions, scope and limitations, and research process which governs the milestone of the study organisation.

Chapter 2 comprises of Literature Review, a written summary of the study based on secondary data. It includes the construction disputes, payment dilemmas in the construction industry, ways to resolve the problems, details of CIPAA 2012 Act, and the effectiveness of implementation of CIPAA 2012 to the construction industry.

Chapter 3, the Research Methodology aims to chew over the approaches of data collection which incorporates the explanation of the whole process in generating a complete dissertation. Research design too is encompassed where the types of data as well as sources of data are displayed.

After data collection, data analysis and findings will be mulled over in Chapter 4. Information collected will be piled up for the ease of analysis by wording expression. The effectiveness of application of CIPAA to the construction industry in terms of payment recovery are determined based on the answers of the interviewees and analysis of data published by AIAC.

Lastly in Chapter 5 will be the Conclusion and Recommendations. It draws the conclusion of the research with some viewpoints to recommend the construction industry

in the future direction and to make the industry players aware of the effectiveness of CIPAA Act in alleviating the payment problems in the construction industry.

### **1.10 Expected Findings**

The author reckons that the anticipated result of the implementation of CIPAA 2012 will reduce payment disputes tremendously besides improving cash flow. The result will also show that only small percentage of participating parties will refer decided adjudication to High Court and Arbitration.

Moreover, the verdict of the research is also expected to support the fact that majority of the decisions released by the adjudicator were in favour of the claimant which allow contractor to receive regular and timely payment that promote cost flow. In addition, the result of this research is also expected to portray that most of the disputants are satisfied with the outcome of the decided adjudication and most of the participating parties opted CIPAA adjudication over other alternative dispute resolution (ADR) process due to the summary nature and cost effectiveness. Lastly, the findings of the dissertation will also exhibit that the respondent would make full payment on the time frame set after an adjudicated decision held in favour of the claimant has been served on the respondent.

### **1.11 Significance or Contribution of the Research**

The immense problems relate to payment are normally faced by all players in construction supply chain namely main contractor, sub-contractor and professionals. Ergo, it is persuasive that the research in this area would provide both personal interest and be beneficial to the stakeholders in the construction industry in terms of conveying the message about how effective is this Act is to help them in claiming back the fee or money that they deserved due to the work done delivered by them for the proprietor.

This dissertation should increase the awareness of both contractors and proprietors towards the presence of CIPAA 2012 besides providing the contractors with a better understanding of their rights to payment and their legal position if payment is in default. Withal, this paper was also expected to grab the attention of the clients so that they can make their payments promptly and timeliness which indirectly improves working rapport between the contractors and employers as well as improves the cash flow of the entire supply chain.

This dissertation also encourages aggrieved claimant (contractors and sub-contractors) to use adjudication as a method to resolve their payment ills by revealing the effectiveness of the said Act after its enforcement. Findings of this study may assist the relevant parties in addressing disputes vis-à-vis delay and non-payment in an effective and timely manner to generate a win-win situation for all participants in the Malaysian construction industry.

### **1.12 Research Scope and Limitation**

The area of research is focusing on the effectiveness of CIPAA 2012 after CIPAA 2012 is practiced in Malaysian construction industry. Thus, the author will only adopt the data from AIAC to generate the findings and also conduct interview with a few adjudicators so as to achieve the objectives set for this dissertation. Limitation for the research is the findings will only be based on the limited sources of data published by AIAC and also it would be based on the perspectives of only a few adjudicators as the Act just started to be enforced four years ago, 2014.

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Clause 30.6(a) of PAM Contract 2006 (With Quantities)

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